THE STEEL CORPORATION CASES.

On April 1, 1902, the directors of the United States Steel Corporation adopted a resolution providing for a conversion of $200,000,000 of its preferred capital stock into second mortgage bonds of the corporation, to be effected by the redemption and retirement of the stock, "out of the bonds or the proceeds of the bonds." In addition, $50,000,000 of these bonds were to be issued for cash at par. The scheme was made expressly contingent upon its adoption by the shareholders, and required the opening of the bond subscription to all the holders of preferred stock.

At the same time a tentative contract was authorized by the directors, also contingent on adoption by the stockholders, known as the Bankers' Contract, whereby a banking house, on behalf of itself and others to be associated with it in a syndicate, agreed to take $100,000,000 of the bond issue; $80,000,000 in exchange for stock to be surrendered, and $20,000,000 for cash, with an option on such additional part of the issue not subscribed for by stockholders at large as it should desire. Upon the bonds so taken the syndicate was to receive a commission of four per cent., amounting to $4,000,000 on the guaranteed amount, and to not more than $10,000,000 in all. Each branch of this project was later approved and adopted in a separate resolution at a specially called stockholders' meeting.

The validity of this scheme was attacked in two suits in the Court of Chancery of the State of New Jersey, known as the Berger[1] and the Hodge[2] suits. In each of them the bond issue was restrained by a preliminary decree of the Vice-Chancellor, which was afterwards reversed in the Court of Errors. In the first, or Berger suit, to which the corporation and the bankers' firm were the only parties

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[1] Berger *v.* U. S. Steel Corporation (N. J. 1902) 53 Atl. 14 (in Chancery) S. C. 53 Atl. 68 (in Errors).

[2] Hodge *v.* U. S. Steel Corporation (N. J. 1902) 53 Atl. 601 (in Chancery); S. C. 54 Atl. 1 (in Errors).

defendant, the opinion of the highest court concerned itself with questions of corporate power; in the other, it considered chiefly the regularity of the corporate action, although in the later case complainant's counsel again raised, in a somewhat varied form, the objection of lack of statutory power. In the second litigation the directors of the corporation individually were added parties.

The Vice-Chancellor granted an injunction to Mrs. Berger, enjoining so much of the bond issue as was not to be for cash, on the ground that a general statute of 1902, understood to have been passed with the special object of authorizing this issue of bonds, was essential to their issue, but was invalid under the New Jersey Constitution because impairing the obligation of the contract of the corporation with its members, by subjecting existing non-participating shareholders to a new mortgage lien, to the prejudice of their stock. This, upon the theory that a reserved legislative power to amend corporate charters does not extend to a change in the contract relations of the corporations even with their own members. This doctrine was in harmony with the current of New Jersey decisions,[1] though hardly with jurisprudence elsewhere.[2]

The Court of Errors, while throwing doubt around the new Jersey doctrine, avoided a dissent from it by holding the Act of 1902 not essential to the issue of bonds in exchange for stock of the corporation, that power already existing under the law of 1896, and adjudging it not an enabling, but, on the contrary, a restrictive act. Inasmuch as the complainant's rights had accrued after and under the Act of 1896, they were subject to it. This result affords an interesting commentary on the uncertainty of curative legislation. The Act designed to facilitate the issue of bonds was, in order to save them, pronounced not an aid to them, but a restriction on them.

It was further held, outside the point passed on by the Vice-Chancellor, that under the New Jersey statute corporations had power to purchase their own shares, either

[1] Kean *v.* Johnson (1853) 9 N. J. Eq. 401. Zabriskie *v.* R. R. Co. (1867) 18 N. J. Eq. 178.

[2] Mayor *v.* Railway Co. (1889) 113 N. Y. 311. Durfee *v.* Old Colony R. R. Co. (Mass. 1862) 5 Allen 230. Venner *v.* U. S. Steel Corp. (1902) 116 Fed. Rep. 1012. 2 Wilgus on Corp. p. 1472, Note.

for cash, or on credit, or in exchange, and to incur debt therefor, and had the further power to pay that debt by their obligations, and that, therefore, the issue of bonds in payment or redemption of the retired stock was within the corporate powers. This was the very marrow of the controversy.

Without noticing the minor aspects of the decision or entering into the details of the case, it may be said that the statute regulating the power to redeem or retire stock prescribed certain conditions precedent to its exercise. One of them made the Act available to companies "whose assets at such time after deducting the amount of its indebtedness, shall be certified in the judgment of the officers making such certificate to be at least equal to the amount of preferred stock issued and outstanding." Such a certificate was held by the Court to be not conclusive, but only presumptive evidence of the amount of assets; and much time was consumed in the second case in a dispute over the valuations made by the Company's officers.

The statute also specified the "ways" which were conditional to its purchase, one of which was "by the purchase at not above par of certain shares for retirement." This was the way relied upon to sustain the retirement of this stock.

On reading the opinions in both cases, it is noticeable that while all other phrases in these statutes have received careful consideration and instructive exposition, there was no discussion of the effect of the words "at not above par." In the final briefs in the Hodge case we find the obstacle to the conversion scheme created by these words pressed upon the attention of the Court, as overlooked in the Berger case, but apparently without avail.

It was vigorously contended in behalf of the complainant that to countenance a purchase of stock by payment in securities of unfixed value was to afford cover for a purchase price above par; that the four per cent. commission to the syndicate in effect raised the price to 104, and that in all probability the bonds when issued would sell at a still higher figure.

That the prophecy miscarried should not rob the argument of its value. It might have proved correct in the

Steel cases; it may be verified in the next kindred case to arise. For instance, a six per cent. first lien on valuable plant and franchises ordinarily commands a market premium. If given at equal face values for stock (as an aggravation, say stock quoted as was the Steel preferred, at 88), would this be a purchase at par? Would it satisfy the real demand of the statute?

This query leads up to the second term of the Court's decision—that the issuing of the bonds was also within the specified statutory corporate powers. The Law of 1896, under which it was formed, provided that the objects of the Company should be set forth in its certificate of incorporation. That certificate set forth in minute detail the particulars of its manufacturing, mining, and transportation operations, and also its holding of patents, real estate, and the stocks of other corporations, and other property. This statement of objects was summed up in the words:

"The business or purpose of the Company is from time to time to do any one or more of the acts and things herein set forth."

Then followed this clause:

"Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations, in payment for property purchased or acquired by it, *or for any other object in or about its business;* to mortgage or pledge any stocks, bonds or other obligations or any property which may be acquired by it to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or heretofore may be authorized by law."

Commenting on this, the Court says:

"Here is expressly provided the right to mortgage all property then held, or thereafter acquired, not only for debts contracted in carrying on its various branches of business, but also for the purpose of attaining or furthering any of its objects.

One of the purposes and objects of the corporation which was contemplated in its inception and provided for by the Act of 1896, and which is now entered upon and which in the estimation of the requisite number of shareholders will be productive of beneficial results, is the retirement of the proposed number of shares by purchase. The object is a lawful one, being expressly recognized by the Corporation Act."

The logic of this reasoning is indisputable if it can be said with fairness that one of the purposes and objects of a corporation is the retirement of a portion of its own shares. This view of the subject seems to overlook the accepted distinction between the chief objects of a corporation which are the ends of its creation and existence, and those minor objects which are part of the machinery for attaining its ends and are enumerated only as among its incidental powers.

It is to be observed that this criticism applies only to the language of the Court, and not of the statute and the charter by which the projectors of the conversion scheme may be supposed to have been guided, and which authorized the issuing of bonds "for any other object in or about its business." The advisers of the Steel Corporation in devising their plan were secure, as they were astute, in relying on the chain of powers contained in these instruments, and we may not assume that they depended upon this link of reasoning furnished us by the Court.

Yet, even so, the doctrine of this decision in its largest scope may be debated in other forums, where the recapitalization of corporations by bond conversion schemes may not be held to be within the legislative intent in providing for the retirement of stock or the issue of bonds. The product of these two powers in conjunction appears to be something quite foreign to the object of either of them taken separately. The corporate capital is weakened; it is partially changed into a debt; the participating stockholder, into a creditor; his fellows are subjected to a superior lien, and the corporate body transformed both as to its basis of credit with the outside world and as to the internal relations of its members. The law on the subject in other States will be varied by the interpretation of diverse local statutes.

In the Hodge case the complainant did not succeed in obtaining a review of the principles decided, either expressly or impliedly, in the Berger case. The additional fact was there shown that out of twenty-four directors eleven were members of the Bankers' Syndicate, under an agreement entitling them to share the bankers' commissions, thereby creating in them an interest presumptively adverse to that of the corporation.

The Vice-Chancellor had again granted an injunction, upon the ground that dividends had not been "continuously declared and paid * * * for the period of at least one year next preceding the meeting," as required as a condition to the issue of bonds by the Act of 1902. On this point of transitory interest he was overruled; but the Court of Errors also decided that where by-laws provide that a majority vote of stockholders shall be binding on the corporation, such a vote is conclusive on every shareholder as to all acts *intra vires*; that the conversion scheme had already in the other case been held within the corporate powers; that all stockholders, even interested directors, vote at a stockholders' meeting in their personal capacity and interest; that a majority vote of stockholders in which the directors participate may authorize or ratify a contract between the Company and a syndicate, of which the directors are active members, provided the stockholders have proper notice of the adverse nature of such interest; that a mere notice of the existence of such an interest is sufficient to put them on inquiry without disclosure of its nature or extent, and that such a contract is not void, but only voidable at the option of the Company and its shareholders.

This statement of the law is fully supported by the authorities cited from the American and English reports, as well as by the reasoning of the Court. Yet there is a growing inclination among our jurists to exact in this kind of notice a specific and detailed disclosure, not only of the plan to be voted upon by the stockholders, but also of every circumstance, such as the nature of the adverse interest of directors, which may legitimately influence the vote. It is realized that though possible it is not easy for the widely dispersed shareholders of a great industrial or transportation corporation to seek such information for themselves. Many do not know how to set about it; others are loath to expend money or time in the quest. The notice, decided to be sufficient in this case, was embraced in the following clause:

> "To further the success of the plan, there has been formed a syndicate, including some directors, which will receive four-fifths of the four per cent. compensation to be paid under the contract with Messrs. J. P. Morgan & Company, mentioned in the notice of stockholders' meeting."

That notice of meeting mentioned the contract and added:

"Of which copies may be obtained by stockholders at the office of the corporation."

Certainly this notice to stockholders, though not detailed, was direct and clear as to the existence of the contract and of an adverse interest under it. It is an instructive fact narrated in the briefs of counsel that not a single application was made for a copy of the contract. The laches of dissentient stockholders in this respect disinclined the Court later to interfere in their behalf.

The rule that the interested directors may vote on their stock in ratification of the contract involving their interest appears to be established in our jurisprudence. Yet that it does not receive cheerful assent, even in New Jersey, may be inferred from the reported language of a vice-chancellor of that State in a recent case.[1] It is noteworthy that in the final briefs of the complainant's counsel all contention against this rule is expressly disclaimed.

On the whole, these cases cannot be regarded as settling any doctrine of law commensurate in importance with the property interests involved. Yet a perusal of the record and the briefs invites a short comment on the status of minority stockholders.

The stress laid by the Court of Errors on the fact that ninety-nine per cent of the stock represented at the meeting, and between seventy and eighty per cent of the entire stock and more than sixty-two per cent. of the stock not held by interested directors was voted in favor both of the stock conversion and of the Bankers' contract, and on the further facts that there was but a single effective complainant in each suit, and that no substantial dissent on the part of stockholders had been shown, emphasizes the

[1] "The following reply of a New Jersey judge on Wednesday, who had been reminded that in the case of Hodge *v.* The United States Steel Company, the opinion of the Court was that trustees have the right to vote a majority of stock to protect their own interests, created considerable discussion. 'I don't agree with the Court,' the judge referred to said. 'No man could hold up his head and second that belief. No court can conscientiously hold that the trustees holding a majority of stock can vote in their own interests as against the interests of the minority. There is no tyranny like the tyranny of such a majority.'"

(*N. Y. Evening Post*, Seaboard Air Line Hearing, Aug. 15, 1903,)

importance of summoning to an assault on great vested interests something more than a shadowy minority or a solitary party plaintiff. In the Berger opinion it is said—

> "The greatest care must be observed that this overwhelming majority of the shareholders are not deprived of their rights by the very few dissentients."

Courts are disinclined to overturn the decision of seventy-five per cent. of a company's stockholders in regard to their own property where no fraud or deceit or oppression appears. The Appellate Court took occasion to remark in the Hodge case—

> "There is an entire absence in the case of anything to show a taint of fraud."

The Court, in the first case, did also justly say—

> "Nevertheless if it appears that the proposed act is without legal authority the complainant cannot be denied her rights."

Obviously this principle is of vital importance. The smallest stockholder acting in good faith should not be hinered in the assertion of his rights in court. Equity furnishes ample means of testing, in a preliminary way, both good faith and substantial interest, as was done in one of these very cases.

The suggestion, coincident with these litigations, made in his message to the Legislature of 1903, by the Governor of New Jersey,[1] that indemnity should be exacted from litigants seeking injunctions, tends towards the impairment of this right, and such a measure would prove injurious to the fond desire of that commonwealth to remain forever the foster-mother of trusts.

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[1] "New Jersey has justly won the confidence of the country because its laws protect alike, and with equal justice, the rights of the people and the rights of property. The result of this confidence has been, that so great a number of corporations have organized under her laws that the fees and taxes from this source are sufficient to pay the annual expenses of the State, to pay a large proportion of the cost of our public education and to leave a handsome surplus besides. * * *.

"It is time the air should be cleared. The corporations have their rights as the individuals have theirs. We undertake here in New Jersey to protect them in their rights. * * * I call your attention to the advisability of passing a law requiring litigants who seek to enjoin corporations or others in the State from carrying out plans adopted by them, to give a bond of indemnity to the party attacked, in such sum as the Chancellor shall deem proper, in case it be finally determined that the applicant for the injunction was not entitled to the writ." (From First Annual Message of Franklin Murphy, Governor of New Jersey—1903.)

While a check upon speculative actions and "strikes," it would shut the door in the face of aggrieved stockholders and shelter culpable directors in their wrongdoing. Nor can it be forgotten that a rule for one must be the law for all. A regulation, salutary when applied to the Steel Corporation, with its vast resources and capable management, may prove a mere cover for fraud in the instance of a company controlled by speculative promoters. Legislation of this character, the outcome of competitive bidding by our Sovereign States for the profits from organization fees and corporation taxes, may in the end defeat its own object. Promoters will come to realize that an educated public enquires into these particulars and learns to shun investment in companies organized under statutes whereby the minority stockholder is subjected to burthens and shorn of common rights and remedies. In this matter straightforward law-making will prove of advantage.

This comment throws no reflection upon the charter of the Steel corporation—taken all in all, a fair though comprehensive one—but is a natural corollary from the decisions construing that charter and a warning, considered timely, against the prevailing trend, both legislative and judicial, toward looser corporation laws.

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